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## A discussion paper on public value in the water sector

Dear Bart,

Thames Water welcomes the opportunity to respond to this consultation. Our core function is to deliver safe, clean drinking water and provide wastewater services 24/7 for 365 days a year to meet current and future customers' demands. Public value is all about what we do and how we do it which is why we have brought it front and centre as one of our Strategic Ambitions.

We know that we can have a positive and lasting impact on society, the natural environment and the communities we are part of through our socio-economic and environmental footprint and public health responsibilities. Our 2019/20 annual report highlights some of the actions we have taken to protect and enhance the environment, support our customers and make a positive impact on the communities in which we operate. For example, our achievements last year include:

- Self-generating over 23% of our electricity needs as part of our commitment to net zero carbon emissions from our operations by 2030;
- Sharing the enjoyment of our sites with our customers to promote a healthy lifestyle and wellbeing, with over 100 sites open to the public for free offering recreational activities;
- Welcoming over 300,000 visitors to Walthamstow wetlands, Europe's largest urban wetlands. We have also just announced the creation of a new wetland in Buckinghamshire
- Investing around £300,000 into an independent Thames Water trust fund, with over 1,300 customers helped by receipt of domestic appliances and beds;
- Installing 48 water fountains across London to date; and
- Engaging with over 35,000 young people to promote care for water and inspire the next generation of engineers.

We have also identified some longer-term priorities that we want to achieve as company:

- Significantly increased investment in the independent Thames Water Trust Fund during 2020/21;

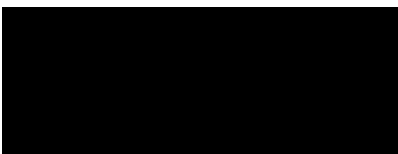
- Instigate a step change in our approach to catchment management through our smarter water catchments trial program, which includes efforts to relieve pressure on ecologically valuable chalk streams;
- Invest to generate more of our own energy as part of our commitment to net zero carbon emissions from our operations by 2030, and to go beyond by 2040;
- Assess the Natural Capital stocks across all our landholdings by 2025;
- Increase biodiversity by 5% at 253 of our sites by 2025; and
- Open more sites to the public, including sites handed back after the construction of the Thames Tideway Tunnel.

These activities taken together are strong evidence that we are actively pursuing a public value agenda, while we are of course also subject to Ofwat's *Board Leadership, Transparency and Governance Principles*, under which Ofwat has found that we have, "provided a clear and thorough explanation of the relationship between their purpose and their strategy, with some using goals, aims and targets to demonstrate their approach and intent to measure progress<sup>1</sup>."

It can be difficult to effectively define an ambition such as public value into a formal legal or regulatory document. This can be because the definition could be too narrow and end up being restrictive, or too wide ranging and too difficult to compare or monitor. As set out above, the industry has embraced its public value obligations and your discussion paper rightly poses questions about how best to achieve the right outcomes, the risks involved and Ofwat's role.

We believe that delivery of public value is embedded in the culture of an organisation and therefore, what business represents so it must be *our* responsibility to develop it for ourselves as demonstrated above within the existing regulatory regime. We think a new approach should be undertaken by Ofwat within this regulatory space to incorporate consideration of public value across your activities and assessment of business plans, recognising water companies are responding to wider policy and regulatory requirements that deliver public value. This will need to be developed at pace if it is to influence the next price review. We suggest developing a new way of working with water companies to implement public value, which builds on ideas contained in *Time to Act, Together: Ofwat's Strategy* (2019). This could be building on the types of conversation with you during the initial development of the paper in an atmosphere of cooperation and co-creation.

Best regards,



Nicola Cocks

Regulation Director

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<sup>1</sup> <https://www.ofwat.gov.uk/wp-content/uploads/2021/02/Board-leadership-transparency-and-governance-%E2%80%93-Report-on-how-companies-are-meeting-the-principles.pdf>

## Annex

In this Annex we provide our detailed comments on each of the questions raised in the discussion paper

### Scope and Ambition

- a) What factors – outside regulation – impact on water companies’ ability to deliver ‘optimal’ public value outcomes when delivering their core services? What are the constraints to meeting ambitions in this area?

There are four classes of factors outside of regulation we would like Ofwat to consider:

1. **Making legitimate multidimensional trade-offs:** across different perspectives, time and resources. Such trade-offs include social, environmental, intergenerational and economic factors that can impact on how public value is provided and perceived by different stakeholders – customers, employees, communities, Government and local authorities and regulators. External factors include:
  - a. Social – population growth, demographics of customer base;
  - b. Environmental – climate and weather, topography, soil type (which can affect the condition of the pipes in the ground);
  - c. Economic – ratio of urban: rural, level of industry and growth and the impact on employment, state of financial markets;
  - d. Situational - age of existing infrastructure; and
  - e. Conflicting perceptions of value from different stakeholders.
2. **The choice of existing non-core services within our communities and how these would be considered within a framework that assesses “optimal” public value outcomes** e.g. education and training, recreation, and volunteering. We may need to assess the impact on these areas and the potential to integrate them into public value delivery.
3. **Implementation challenges for optimal public value:** We need to address the following issues for effective public value delivery and therefore optimal outcomes:
  - a. Developing research, dialogue and general ongoing engagement of our customers;
  - b. Developing new reporting lines of our performance;
  - c. Finding ways of auditing our activities and charting our performance;
  - d. Building in agility of our response to what could be dynamic consumer interests;
  - e. Community communication and listening strategies across diverse groups with different values and political viewpoints; and
  - f. Developing metrics to identify tangible outcomes.

- b) What are the risks in the pursuit of greater public value; and what could companies, and/or Ofwat, do to mitigate these risks?

Many factors need to be considered when making decisions to both consider and balance the variety of stakeholder opinions regarding public value. While our actions are informed by engagement with our customers, stakeholders and communities, there is a risk of different perceptions of the value of our actions. Table 1 shows the type of risks given our commitment to pursuing greater public value, and potential mitigation measures.

**Table 1 Risks Associated with the introduction of public value**

Risk	Regulated company's mitigation strategy	Relationship with Ofwat
<b>Different interest groups place different value on public value so there is no consensus view</b>	Carefully designed dialogue with our customers and stakeholders to inform decision-making through well thought out engagement plan.	Part of developing a new way of working with the regulator.
<b>Failure to fully optimise public value through conflicts in trade offs</b>	Guidance from Ofwat on trade-offs would be welcome.	Part of developing a new way of working with the regulator.
<b>Varied maturity of companies to define and deliver public value (e.g. natural capital)</b>	Industrywide best practice sharing.	Ofwat to recognise the different maturity levels for individual companies when making decisions on outcomes and performance commitment levels.
<b>Lack of cooperation with electricity or gas networks who are also delivering public value services</b>	Thames Water, together with the rest of the water industry, needs to consider how to coordinate and collaborate with other industries in this space. (NB we have access to the Priority Service Care Register through a joint agreement with energy companies' central systems).	Ofwat to work with Ofgem regarding packages for fuel poverty that are funded in RII02, for example. Strong encouragement of cross sector working.

**c) In pursuit of better public value outcomes, to what extent should companies focus on an enabling culture that drives public value holistically; versus a more discrete, targeted approach?**

Companies need to embed their purpose in every decision and action if they are to be a purpose-driven business- and culture has a fundamental role to play. There are already a growing number of different cultures within companies – health and safety culture, customer service culture, carbon culture, sustainability culture. Public value can also include some of these.

Since public value is a key part of the culture and values of an organisation, it must be our responsibility. In 2019/20 we defined our purpose, re-evaluated our strategy, set new near-term priorities and created behaviours to support our longstanding values. By aligning what we need to do with how we need do it, we entered the new regulatory period with a clear direction for the future as we commit to living our purpose. 'Generating public value' is our third strategic ambition. We rely heavily on the environment for the provision of our services, which is why environmental

protection and enhancement is a key theme within this strategic ambition. It also covers our approach to providing support for our customers outside the standard remit of a water company, making a positive impact on the communities in which we operate and sharing the enjoyment of our sites with our customers to promote a healthy lifestyle and wellbeing.

In this context the regulatory framework already allows for:

- Reputational ODIs that capture activity associated with public value;
- procurement policy reporting;
- investment appraisal incorporating public value in the price control; and
- other activities that are related to public value that can be measured and developed by individual water companies.

## Incentives and barriers

### d) How does the regulatory framework contribute to, or limit, companies' ability to deliver better public value outcomes?

The incentive framework in the price review is at present neutral to public value, and does not explicitly fund activity to facilitate it. Issues can arise when we need to make trade-offs between resources and management time within the Price Review focussed on public value. For example, the current regulatory framework can be a barrier for companies to explore nature-based solutions. Under the totex allowance and ODIs, companies could pursue conventional capital programmes for environmental schemes in order to achieve the outcomes in a timely manner with high certainty, whereas a nature-based solution may be much cheaper and generate additional benefit for the environment and society (e.g. increasing wetlands for phosphorus removal) but could take much longer and face more uncertainty. If the regulatory framework has the flexibility to encourage companies to trial nature-based solutions, allow these trials to succeed or fail over a period, and promote sharing all lessons learnt, this will incentivise the development of optimal environmental solutions with the best economic value and public value.

In this way, the current regulatory framework could limit public value considerations in investment. The current measurement of efficiency of networks does not capture the types of trade-offs captured above. To address this, Ofwat could work with water companies to adapt the regulatory framework to allow the full value of a particular solution to customers to be assessed, particularly for those solutions that would otherwise look inefficient when considered in isolation.

The current reporting requirements do not specifically consider public value. As set out above., public value is often subjective and therefore cannot be easily measured. For example, within our public value framework we have a commitment to reach every schoolchild with our education programme which is measured by the number of schoolchildren reached. We consider that this delivers considerable public value, but the value is not necessarily reflected in the figures/metrics reported. At the moment, the public value benefit would have to be described in the narrative. Our suggestion is that these wider narratives should be part of the accepted evidence of regulatory submissions and part of the assessment of performance.

### e) What role, if any, should the price review play in encouraging or incentivising companies' delivery of public value?

We fully support future price reviews including PR24 increasingly considering public value. Some public value activities may require specific funding if they go over and above delivery of our core activities. More generally, we would welcome increased recognition and consideration of the reputational value of delivering public value. We would encourage Ofwat to work with water

companies to develop reputational incentives and other measures outside of the performance commitments framework as a way of incentivising and recognising such initiatives.

Given that each company is likely to have a different public value framework, driven by customer and stakeholder needs and the social, environmental, and economic factors listed above, the framework needs to be flexible and non-prescriptive. This will allow each company to take whichever approach is best based on their circumstances to enhance delivering public value, instead of focusing on reporting metrics. As Ofwat states in the discussion paper<sup>2</sup>, “[Ofwat] are also mindful that a broad pursuit of public value objectives could have unintended and even adverse consequences. Our collective efforts should augment and reinforce companies’ delivery of their essential purpose and core activities, and not lead to a loss of focus on these fundamentals.”

An explicit consideration of public value initiatives, and funding for these through the price control framework would more strongly encourage all companies to consider and implement these schemes. Providing greater regulatory certainty would also promote companies to work together and share learning. As more schemes are delivered, and greater value is captured, then the regulatory framework could become more effective in assessing both the schemes proposed and the benefits that they deliver.

It is likely that customers in different regions may have different views of public value. If the price control remains flexible to consider regional and customer-supported schemes then this would again encourage further investment in delivery of public value benefits.

## Understanding impact

### f) What are the markers of progress on public value, both in the context of enabling culture and outcomes?

We note that public value can be subjective, and so the markers of progress may be different for different initiatives and different water companies. However, we would suggest that certain KPIs could be measured and monitored such as:

- Company-wide initiatives to encourage involvement in programmes and tracking actual involvement which could include;
  - the number of days used by employees for volunteering;
  - the number of customers benefiting from community initiatives;
  - the number of initiatives and volunteers actively involved in initiatives;
  - the number of culture-related articles published on the company intranet, along with metrics regarding their views and shares; and
  - recruitment and retention metrics relating to PV activities.
- Behavioural KPIs: Pulse surveys that track how behaviours spread over time representing a metric that comes directly from employees.
- Anecdotes: Personal observations of people doing something outside the norm, big or small, should be recorded and shared across the organisation. Storytelling is a strong tool for demonstrating and sharing public value outcomes.
- Third party benchmarking/ comparison activities to monitor progress against a public value target, for example we use the London benchmarking assessment in order model to measure and report our community investment that allows us also to learn best practice on measuring and marketing social impact activities.

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<sup>2</sup> Ofwat, A discussion paper on public value in the water sector, December 2020. Page 11.

In all of the above, transparency is crucial backed up by robust evidence. Progress should be publicly reported where appropriate and reported in a way that is useful for stakeholders i.e. annual reports, website, press releases and unique/bespoke reports.

### g) What role, if any, should Ofwat have in monitoring progress? How else can we, customers and other stakeholders be assured that genuine and meaningful progress continues to be made?

As has been suggested in response to question (f), public reporting of outcomes would allow all stakeholders to more easily monitor progress. Our view is that this could be a relatively easy amendment to existing Board leadership and reporting requirements. We would encourage Ofwat to:

- Ensure there is robust evidence and substance behind outcomes and publicly promote what water companies have achieved;
- Avoid creating standardised metrics or frameworks, but Ofwat could provide or identify some guidance, principles, or best practice examples;
- Ensure any guidance or examples from other industries is transferable; and
- Consider developing high level principles around public value e.g. there are a set of 10 pragmatic, realistic and flexible Natural Capital Principles which we are working with as we continue to develop our company approach to Natural Capital<sup>3</sup>. These were developed by water companies and regulators.

### Other

### h) Is there anything else Ofwat should be considering in order to meet our objectives on public value?

We support Ofwat incorporating public value into a broader approach which goes beyond traditional thinking about licence changes, price controls and reporting regimes. We suggest that Ofwat works openly and collaboratively with water companies to understand, consider, implement and promote public value initiatives. This would build on the constructive conversations already taking place through Ofwat's initial development of this consultation paper. We welcome the focus on cooperation and co-creation. Public value is reliant on innovation, and this will inevitably lead to both successes and failures. We believe that Ofwat and water companies working together will enable us to rise to the challenge and deliver in this crucial area.

As we work together, it would be useful to develop a common understanding of what a socially purposed organisation behaves like. This will be very helpful for the development of our policies and can also allow Ofwat to recognise that each company faces different challenges, opportunities and starting points to deliver public value to the communities we supply.

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<sup>3</sup> See NAO Principles of Natural Capital Accounting